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Nos. 945, 946 and 947

In the Supreme Court of the United States

OCTOBER TERM, 1946

JOHN P. McWILLIAMS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ESTATE OF SUSAN P. McWILLIAMS, DECEASED, JOHN P. McWILLIAMS, EXECUTOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

BROOKS B. McWILLIAMS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute involved	2
Statement	3
Summary of argument	7
Argument:	
The court below correctly held that transactions in question were sales or exchanges, "indirectly," between the members of a family within the meaning of Section 24 (b) (1) of the Internal Revenue Code	9
1. Background of the statutory provisions	10
2. The sales here involved fall within Section 24 (b) (1)	14
3. The Tax Court's interpretation of Section 24 (b) (1) was reviewable by the Court below	21
Conclusion	23

CITATIONS.

Cases:	
Allen v. *Commissioner*, 38 B. T. A. 160	15
Angelus Milling Co. v. *Commissioner*, 325 U. S. 293	22
Arguimbau v. *Commissioner*, 31 B. T. A. 604	16
Bingham, Trust of, v. *Commissioner*, 325 U. S. 365	22
Brochon v. *Commissioner*, 30 B. T. A. 404	15
Choate v. *Commissioner*, 324 U. S. 1	22
Claridge Apartments Co. v. *Commissioner*, 323 U. S. 141	22
Cole v. *Helburn*, 4 F. Supp. 230	16
Commissioner v. *Behan*, 90 F. 2d 609	16
Commissioner v. *Court Holding Co.*, 324 U. S. 331	18
Commissioner v. *Disston*, 325 U. S. 442	22
Commissioner v. *Estate of Bedford*, 325 U. S. 283	22
Commissioner v. *Estate of Field*, 324 U. S. 113	22
Commissioner v. *Hale*, 67 F. 2d 561	12
Commissioner v. *Harmon*, 323 U. S. 44	22
Commissioner v. *Ickheimer*, 132 F. 2d 660	17
Commissioner v. *Kohn*, 158 F. 2d 32	16
Commissioner v. *Smith*, 324 U. S. 177	22
Commissioner v. *Wemyss*, 324 U. S. 303	22
Commissioner v. *Wheeler*, 324 U. S. 542	22
Crane v. *Commissioner*, No. 68, this Term, decided April 14, 1947	22

Cases—Continued Page

Deputy v. *duPont*, 308 U. S. 488 20
Dobson v. *Commissioner*, 320 U. S. 489 ..... 21, 22
Douglas v. *Commissioner*, 322 U. S. 275 22
Duel v. *Hollins*, 241 U. S. 523 19
DuPont v. *Commissioner*, 118 F. 2d 544, certiorari denied, 314 U. S. 623 12
Equitable Society v. *Commissioner*, 321 U. S. 560 20
Esperson v. *Commissioner*, 49 F. 2d 259, certiorari denied, 284 U. S. 658 12
Fondren v. *Commissioner*, 324 U. S. 18 22
Gorman v. *Littlefield*, 229 U. S. 19 19
Gregory v. *Helvering*, 293 U. S. 465 18
Griffiths v. *Commissioner*, 308 U. S. 355 17
Helvering v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686 20
Helvering v. *Mitchell*, 303 U. S. 391 12
Helvering v. *Northwest Steel Mills*, 311 U. S. 46 20
Higgins v. *Smith*, 308 U. S. 473 18
Hill v. *United States*, 12 F. Supp. 798 12
Interstate Transit Lines v. *Commissioner*, 319 U. S. 590 20
McDonald v. *Commissioner*, 323 U. S. 57 ..... 20, 22
Minnesota Tea Co. v. *Helvering*, 302 U. S. 609 18
Mitchell v. *Commissioner*, 32 B. T. A. 1093, reversed, 89 F. 2d 873 12
New Colonial Co. v. *Helvering*, 292 U. S. 435 20
Peters v. *Commissioner*, 28 B. T. A. 976, appeal dismissed, 69 F. 2d 999 12
Porter v. *Commissioner*, 36 B. T. A. 475 16
Powell v. *Commissioner*, 94 F. 2d 483 16
Putnam, Estate of, v. *Commissioner*, 324 U. S. 393 22
Security Mills Co. v. *Commissioner*, 321 U. S. 281 22
Shoenberg v. *Commissioner*, 77 F. 2d 446, certiorari denied, 296 U. S. 586 16
Uihlein v. *Commissioner*, 30 B. T. A. 399, affirmed, 82 F. 2d 944 12
United States v. *Amer. Trucking Assn's*, 310 U. S. 534 20
Webre Steib Co. v. *Commissioner*, 324 U. S. 164 22
White v. *United States*, 305 U. S. 281 20
Zimmerman v. *Commissioner*, 36 B. T. A. 279, reversed, 100 F. 2d 1023 12

Statutes:

Internal Revenue Code:
Sec. 23 (26 U. S. C. 1940 ed., Sec. 23) 20
Sec. 24 (26 U. S. C. 1940 ed., Sec. 24) 2, 7, 9, 10, 4, 18, 19, 20
Revenue Act of 1934, c. 277, 48 Stat. 680:
Sec. 24 11

Miscellaneous:

	Page
78 Cong. Rec. 2510, 2661, 2662	11, 12
H. Doc. No. 260, 75th Cong., 1st Sess.	14
H. Doc. No. 337, 75th Cong., 1st Sess., pp. 14–15	14
H. Rep. No. 704, 73d Cong., 2d Sess., pp. 1, 23 (1939–1 Cum. Bull. (Part 2) 554, 571)	13
H. Rep. No. 1546, 75th Cong., 1st Sess., p. 26 (1939–1 Cum. Bull. (Part 2) 704, 722–723)	14
Preliminary Report of a Subcommittee of the Committee on Ways and Means on Prevention of Tax Avoidance, 73d Cong., 2d Sess., p. 15	13
S. Rep. No. 558, 73d Cong., 2d Sess., p. 27 (1939–1 Cum. Bull. (Part 2) 586, 607)	14
1 Williston on Sales (2d ed.), Secs. 146–159	19

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OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 11–16) is reported in 5 T. C. 623. The

opinion of the Circuit Court of Appeals (R. 101–106) is reported in 158 F. 2d 637.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on December 2, 1946. (R. 97–99.) The petition for writs of certiorari was filed on January 24, 1947 and was granted on March 3, 1947 (R. 108). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Section 24 (b) (1) of the Internal Revenue Code disallows deductions on account of losses from sales "directly or indirectly * * * Between members of a family". In this case, in accordance with a pre-arranged plan to establish tax losses, a spouse sold shares of stock on the New York Stock Exchange, and on the same day, an identical number of shares of the same stock (bearing different certificate numbers) was purchased on the exchange for the account of the other spouse. The question presented is whether, as a matter of law, the provisions of Section 24 (b) (1) are rendered inapplicable by such a device.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 24. ITEMS NOT DEDUCTIBLE.

* * * * * *

(b) *Losses from Sales or Exchanges of Property.*—

(1) *Losses Disallowed.*—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

(A) Between members of a family, as defined in paragraph (2) (D);

* * * * *

(2) *Stock ownership, family, and partnership rule.*—For the purposes of determining, in applying paragraph (1), the ownership of stock—

* * * * *

(D) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants;

* * *

* * * * * *

(26 U. S. C. 1940 ed., Sec. 24.)

STATEMENT

The facts as stipulated (R. 20–77) and as found by the Tax Court (R. 11–14) are substantially as follows:

John P. McWilliams and Brooks B. McWilliams are husband and wife, and are residents of Cleveland, Ohio. Susan P. McWilliams, deceased, was the mother of John P. McWilliams. She died in November, 1941, and John P. McWilliams was appointed executor of her estate. (R. 12.)

Mr. McWilliams is president of the Youngstown Steel Door Company. In 1940 and 1941 he

bought and sold a considerable amount of securities for his own and his wife's account and also for his mother's account until her death. His wife and mother both had large estates of their own which he managed for a number of years. (R. 12.)

The sales of securities which gave rise to the losses here in controversy admittedly were for the purpose of establishing tax losses. In each instance Mr. McWilliams would give his broker an order by phone to sell for his or his wife's, or his mother's account a certain number of shares of a particular stock at market and, at the same time, would instruct the broker thereafter to purchase at as nearly the same price as possible a like number of shares of the same stock for the account of one of the others. In each instance the broker was told that the sale was for the purpose of establishing a tax loss. (R. 12.)

During the taxable years the following shares of stock were sold by Mr. McWilliams for his individual account and for his wife's account (R. 12–13):

John P. McWilliams—Year 1941:

700 shares of International Nickel of Canada, Ltd.
200 shares of Eastman Kodak Company.
700 shares of General Electric Company.
100 shares of Monsanto Chemical Company.
100 shares of Cerro de Pasco.

100 shares of Westinghouse Electric Company.

Brooks B. McWilliams—Year 1940:

300 shares of General Electric.
100 shares of Standard Oil Company of New Jersey.
200 shares of International Nickel Company of Canada, Ltd.

Brooks B. McWilliams—Year 1941:

1,000 shares of Basic Refractories, Inc.
300 shares of Libby-Owens-Ford Glass Company.
100 shares of E. I. DuPont deNemours Company.
200 shares of General Motors Corporation.
100 shares of American Tel. & Tel. Company.
200 shares of Liggett & Myers Tobacco Company.

All of the above securities were sold pursuant to orders given to Curtiss-House & Company, stockbrokers in Cleveland, Ohio, and were executed on the New York Stock Exchange in the regular manner by Clark, Dodge & Company, members of the New York Stock Exchange and correspondents of Curtiss-House & Company. The securities had all been acquired and held by the taxpayers more than 18 months prior to their sale. The purchasers of the securities were unknown to the taxpayers. (R. 13.)

At the time that Mr. McWilliams placed the orders for sale of the above securities for his individual account he instructed his brokers to purchase a like number of the same shares at as nearly the same price as possible for the account of his wife. Likewise, when giving the orders to sell the shares for his wife's account he instructed his brokers to purchase a like number of the same shares for his individual account. These instructions were carried out and new certificates bearing different numbers from those sold were issued to the taxpayers. The purchase orders were executed in the same manner as the sales orders. (R. 13.) It appears that in each instance the purchase orders were in fact executed on the same days and at precisely the same prices as the matching sales orders. (R. 23–24, 57–59.)

His wife in 1940 and 1941 owned property greatly in excess of the amounts involved in the transactions under consideration. During all of her married life her securities have stood in her own name and have been kept separate from those of her husband. She has maintained a separate bank account and she and taxpayer have filed separate income tax returns. (R. 13–14.)

On the above-mentioned sales Mr. McWilliams claimed long-term capital losses of $21,276.53 in 1941, and his wife claimed similar losses of $5,592.49 in 1940, and $13,946.95 in 1941. The deductions were disallowed by the Commissioner as coming within the provisions of Section 24 (b)

of the Internal Revenue Code, which denies losses from sales "directly or indirectly * * * Between members of a family * * *." (R. 14.)

Under substantially the same circumstances as those described above, relating to the sales and purchase of securities by Mr. McWilliams and his wife, he on November 28, 1940, sold 100 shares of Eastman Kodak Company stock for the account of his mother, Susan P. McWilliams, and on the same day purchased a like number of the same shares at the same price for his individual account. A long-term capital loss on the sales of those shares in the amount of $1,755.79 was claimed in the return filed by Susan P. McWilliams, and was disallowed by the Commissioner. (R. 14, 45.)

The Tax Court decided that the taxpayers were entitled to deduct the losses in question on the ground that the transactions between the various taxpayers did not constitute sales, directly or indirectly, between the members of a family within the meaning of Section 24 (b) (1) of the Internal Revenue Code. The Commissioner appealed to the Circuit Court of Appeals for the Sixth Circuit which reversed the decision of the Tax Court, with Judge Miller dissenting.

SUMMARY OF ARGUMENT

The statutory provisions here involved were first enacted in the Revenue Act of 1934. Congress had been deeply concerned with devices for

tax avoidance and the 1934 Act was primarily a loophole-closing statute. One of the tax-avoidance techniques commonly employed was the sale of securities between members of a family in order to establish loss deductions, thereby reducing the tax that would otherwise be imposed upon income actually received. This basic device had appeared in a variety of forms, and received widespread attention, particularly in such notorious cases as that of Charles E. Mitchell.

Prior to the 1934 Act, the Government challenged such sales, but was successful only where it could be shown that they were not *bona fide*. However, the intimacy of the family relationship enabled persons to enter into transactions having the outward appearance of sales which were in fact mere shams, and it was exceedingly difficult for the Government to establish the absence of *bona fides* since the facts were generally within the control of the parties themselves. Accordingly, in order to eliminate this device effectively, Congress provided that no deductions should be allowed in any case on account of loss from sales or exchanges between members of a family. And knowing that such transactions could be accomplished in an almost infinite variety of ways, Congress further provided that there was to be no deduction whether the sales or exchanges be executed "directly or indirectly." This sweeping language aptly describes the broad legislative aim that anticipatory arrangements however circui-

tous or skillfully devised may not be availed of to circumvent the purpose of Congress; it conveys the meaning that the plan must be looked at as a whole, and that the true nature of the transaction is not to be disguised by interposing intermediate steps between the initial step and the end result.

The court below was not precluded under the rule of the *Dobson* case from reversing the judgment of the Tax Court. The decisions of the Tax Court did not rest upon the mere application of the statute to a particular set of facts. The Tax Court had laid down a general rule, namely, that the statute is inapplicable in every case where the Stock Exchange and unknown purchasers and sellers are interposed between the original sale by the taxpayer and the final purchase by a member of his family. Its decision therefore presented a clear cut question of law, as to the scope of an act of Congress, and was therefore subject to appellate review.

ARGUMENT

THE COURT BELOW CORRECTLY HELD THAT TRANSACTIONS IN QUESTION WERE SALES OR EXCHANGES "INDIRECTLY" BETWEEN THE MEMBERS OF A FAMILY WITHIN THE MEANING OF SECTION 24 (b) (1) OF THE INTERNAL REVENUE CODE

Section 24 (b) (1) (A) of the Internal Revenue Code, *supra*, pp. 2–3, provides in part that in computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly, between members of a family, and Section 24 (b)

(2) (D), *supra*, provides in part that the family of an individual shall include his spouse and his ancestors.

There is no dispute as to the facts in this case; most of them were stipulated (R. 20–77).

The only substantial question in this case, under the findings as made by the Tax Court, is one of statutory construction. The court below has held that the interposition of the Stock Exchange does not, as a matter of law, remove the transaction from the provisions of Section 24 (b) (1), where the sale and purchase of identical stock interests by members of a family are executed pursuant to a pre-arranged plan. The Tax Court, on the other hand, relying on a prior decision, has held as a matter of law, that (R. 16):

> * * * where listed securities are sold through the Stock Exchange to an unknown purchaser, and like securities are purchased through the Exchange from an unknown seller by some person having a relationship to the seller such as that described in section 24 (b) (1), Internal Revenue Code, the transaction does not constitute a sale of property upon which a loss deduction is denied under the statute.

We submit that the court below correctly reversed the judgment of the Tax Court, since this interpretation of the statute unduly restricts its scope, and does violence to the legislative purpose.

1. *Background of the statutory provisions.*—The provisions of Section 24 (b) (1) of the In-

ternal Revenue Code, here involved, first appeared in the law as Section 24 (a) (6) of the Revenue Act of 1934 (c. 277, 48 Stat. 680). The purpose of these provisions and the general aim of the 1934 Act itself are important factors to be kept in mind in construing the statute.

The 1934 Act was designed primarily as a loophole-closing statute. Widespread abuses under pre-existing law had been brought to the attention of Congress (cf. 78 Cong. Rec. 2664). Representative Doughton, in expounding upon the bill which later became the 1934 Act, stated that it was intended to raise additional revenue "not through any material increase in tax rates but chiefly by the prevention of tax avoidance", and he noted that "a great many of our wealthy taxpayers have found means, through expert legal advice, to avoid the surtaxes * * *". 78 Cong. Rec. 2510.

A familiar device to avoid surtax, where the taxpayer had investments that showed paper losses, was the sale of such investments to a member of the taxpayer's family. In this manner, the taxpayer would be able to claim the loss as a deduction for tax purposes, and yet keep the investments within the family, presumably subject to ready reacquisition by him whenever he should desire. The Commissioner challenged this device in a number of cases, and was successful where it was shown that the transaction was not "bona fide". The case of Charles E. Mitchell was perhaps one of the most notorious, and received

widespread attention. See *Mitchell* v. *Commissioner*, 32 B. T. A. 1093.[1] Cf. *DuPont* v. *Commissioner*, 118 F. 2d 544 (C. C. A. 3), certiorari denied, 314 U. S. 623; *Esperson* v. *Commissioner*, 89 F. (2d) 259 (C. C. A. 5), certiorari denied, 284 U. S. 658. However, since the control of the facts was generally in the hands of the taxpayer himself, the Government encountered considerable difficulty in establishing that a particular sale was lacking in *bona fides*.[2] It became increasingly clear that effective enforcement of the statute

[1] This case also involved civil fraud penalties, and to that extent the decision was reversed by the Circuit Court of Appeals for the Second Circuit by reason of a prior acquittal of the taxpayer in a criminal case. 89 F. 2d 873. However, this Court, in turn, reversed the judgment of the Circuit Court of Appeals. *Helvering* v. *Mitchell*, 303 U. S. 391.

The *Mitchell* case was specifically called to the attention of Congress in connection with the very provisions here involved. In explaining these provisions to the House, Representative Hill stated (78 Cong. Rec. 2662):

"We have also provided in this bill that transfers between members of the family for the purpose of creating a loss to be offset against ordinary income shall not be recognized for such deduction purposes. This will meet the Mitchell tax-avoidance case."

[2] As illustrations of the approach of the Board of Tax Appeals and of the courts to the problem of sales between husband and wife under the law prior to 1934, see *Zimmermann* v. *Commissioner*, 36 B. T. A. 279, reversed, *per curiam*, on another issue, 100 F. 2d 1023 (C. C. A. 3); *Peters* v. *Commissioner*, 28 B. T. A. 976, appeal dismissed, 69 F. 2d 969 (C. C. A. 1); *Uihlein* v. *Commissioner*, 30 B. T. A. 399, affirmed, 82 F. 2d 944 (C. C. A. 7); *Hill* v. *United States*, 12 F. Supp. 798 (C. Cls.); *Commissioner* v. *Hale*, 67 F. 2d 561 (C. C. A. 1).

would be possible only if deductions for losses were disallowed in all cases of sales within the family group. The report of a subcommittee of the House Ways and Means Committee in 1938, which made a general study of tax avoidance, proposed that the statute be amended to deny deductions in such cases, and it concluded that (Preliminary Report of a Subcommittee of the Committee on Ways and Means on Prevention of Tax Avoidance, 73d Cong., 2d Sess., p. 15):

> * * * It is believed that the recommendation of the subcommittee, if followed, will effectually close this opportunity for tax avoidance.

The recommendation was adopted by the full Ways and Means Committee. The Committee Report stated that the primary purpose of the Revenue Act of 1934 was "to increase the revenue by preventing tax avoidance." H. Rep. No. 704, 73d Cong., 2d Sess., p. 1 (1939–1 Cum. Bull. (Part 2) 554, 571). As to the purpose of Section 24 (a), (6) of the Act the Committee Report stated (p. 23):

> Experience shows that the practice of creating losses through transactions between members of a family and close corporations has been frequently utilized for avoiding the income tax. It is believed that the proposed change will operate to close this loophole of tax avoidance.

See also S. Rep. No. 558, 73d Cong., 2d Sess., p. 27 (1939–1 Cum. Bull. (Part 2), 586, 607).[3]

2. *The sales here involved fall within Section 24 (b) (1).*—It seems clear both from the broad language of the statute and from the legislative background that Congress has plainly expressed its will that no deductions shall be allowed on account of transactions, however executed, which amount to nothing more than a reshuffling of the family portfolio. Obviously, a sale between husband and wife could be executed in innumerable ways. Congress was aware of the ingenuity of tax experts and was undoubtedly also aware of the futility of attempting to catalogue every conceivable device by which such a sale could in effect be

[3] The Revenue Act of 1936 simply reenacted Section 24 (a) (6) in its previous form. In June 1937, however, the President in a special message to Congress urged a further effort to prevent tax avoidance. H. Doc. No. 260, 75th Cong., 1st Sess. A special Joint Committee of Congress on Tax Evasion and Avoidance was formed and included in its recommendations was the provision for the prohibition of losses between a fiduciary of a trust and any beneficiary thereof. H. Doc. No. 337, 75th Cong., 1st Sess., pp. 14–15. The recommendation was adopted with the following explanation incorporated in the House Committee Report (H. Rep. No. 1546, 75th Cong., 1st Sess., p. 26 (1939–1 Cum. Bull. (Part 2) 704, 722–723)):

"Under existing law section 24 (a) (6) of the Revenue Act of 1936, losses are specifically denied in the case of sales or exchange of property between members of a family or between a shareholder and a corporation in which such shareholder and his immediate family owns more than 50 percent in value of the outstanding stock. This provision of existing law is not exclusive and the

achieved.[3] Instead of attempting such particularity, Congress wisely used general language and plainly expressed its will by disallowing deductions on all sales between members of a family, whether the sales be made "directly or indirectly". In this context, the word "indirectly" speaks volumes.

It seems inconceivable that in using such comprehensive language Congress nevertheless in-

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Government may still deny losses in the case of sales or exchanges not specifically covered thereby (for instance, between uncle and nephew) if such sales or exchanges are not bona fide. However, because the evidence necessary to establish the fact that a sale or exchange was not made in good faith is almost wholly within the knowledge of the person claiming the deduction, the Government has encountered considerable difficulty in sustaining the disallowance of the deduction in a great many cases. Moreover, the specific provisions of section 24 (a) (6) of existing law have proved inadequate to meet many situations of this type. Accordingly, your committee proposes the amendment of this section to provide certain additional restrictions on deductions of this character. However, as in the case of the provisions of existing law, it is not intended by this amendment to imply any legislative sanction of claiming deductions for losses on sales or exchanges in cases not covered thereby, where the transaction lacks the elements of good faith or finality, generally characterizing sales and exchanges of property."

[3] For examples of such devices, see *Allen* v. *Commissioner*, 38 B. T. A. 160 (purported gift of money by husband to wife followed by sale of stock to her through a broker); *Brochon* v. *Commissioner*, 30 B. T. A. 404 (stock held by taxpayer on margin was sold by broker and at the same time a like amount of same stock was purchased on margin by same broker in the name of taxpayer's wife, the taxpayer being required to guarantee his wife's ac-

tended to leave a loophole for such transactions as are involved herein. We submit that the court below correctly interpreted the statute as embracing the present situation. The same result was also reached by the Circuit Court of Appeals for the Fourth Circuit in *Commissioner* v. *Kohn*, 158 F. 2d 32. The court said (158 F. 2d at 34):

> If the adverb "indirectly" in the statute has any meaning (as Congress unques-

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count); *Porter* v. *Commissioner*, 36 B. T. A. 475 (sale by husband and purchase by wife of same securities on same day through same broker, the husband making a "gift" of the proceeds of his sale to his wife with which she paid for her purchases); *Arguimbau* v. *Commissioner*, 31 B. T. A. 604 (sale by wife and purchase by husband on same day through same broker of same securities, followed by wife depositing the amount of the purchase price to husband's account); *Cole* v. *Helburn*, 4 F. Supp. 230 (W. D. Ky.) (sale by taxpayer and purchase by son on following day through same brokers of same securities, taxpayer "lending" his son the amount of the purchase price; loan never paid and six months later stock reacquired by taxpayer from son); *Shoenberg* v. *Commissioner*, 77 F. 2d 446 (C. C. A. 8), certiorari denied, 296 U. S. 586 (sale by taxpayer of securities through a broker and purchase on same day of the same securities by his controlled corporation, the taxpayer reacquiring the securities from the corporation more than thirty days later); *Commissioner* v. *Behan*, 90 F. 2d 609 (C. C. A. 2) (sales and purchases on same day by husband and wife through same broker, the seller making a "gift" of proceeds of sale to the purchaser); *Powell* v. *Commissioner*, 94 F. 2d 483 (C. C. A. 1) (sale by taxpayer of stock through brokers and purchase on same day by a trust of which taxpayer was trustee of identical securities, followed more than thirty days later, by sale by trust of same stock through brokers and purchase on same day of identical securities by taxpayer).

> tionably intended), it must have been used to prevent just such transactions as are here involved. Otherwise evasion through the family device is almost invited.

A contrary holding appears in *Commissioner* v. *Ickelheimer*, 132 F. 2d 660 (C. C. A. 2), but we submit that Judge Learned Hand's dissenting opinion states the correct view. He said (132 F. 2d at 662):

> * * *. Here we can have no doubt of the purpose of what Congress was aiming at; and that, I submit, we truncate, if we do not include transactions by which, in accordance with a preexisting design, property passes by whatever combination of moves at a substantially unchanged price from one member to the other of any of the specified pairs. Finally there is no difference between on the one hand, selling units of fungibles and buying other units, and on the other the sale of single units. That seems so obvious that I shall not labor the point; * * *.

Indeed, even if Congress had not used the words "directly or indirectly", it could have been argued persuasively that such transactions as are here involved constitute sales between the parties. For, as this Court has often held, the substance of a transaction rather than its form is the determinative criterion. Cf., e. g., *Griffiths* v. *Commissioner*, 308 U. S. 355. "A given result at the end of a straight path is not made a different

result because reached by following a devious path." *Minnesota Tea Co.* v. *Helvering*, 302 U. S. 609, 613. Cf. *Gregory* v. *Helvering*, 293 U. S. 465; *Higgins* v. *Smith*, 308 U. S. 473; *Commissioner* v. *Court Holding Co.*, 324 U. S. 331. By the use of the words "directly or indirectly" in Section 24 (b) (1) Congress has, we submit, enacted in apt language the principles embodied in the foregoing cases. The use of the Stock Exchange as a circuitous means for shifting the investment from one member of the family to another is precisely the type of situation to which the adverb "indirectly" was meant to apply.

The holding of the Tax Court gives improper emphasis to the word "between" used in Section 24 (b) and unwarranted importance to the fact that when a sale or purchase is made upon the Stock Exchange the seller deals with an unknown purchaser and the buyer deals with an unknown seller. This view disguises the transaction by mere formalism and in effect deprives the word "indirectly" used in the statute of substantial meaning. The tracing of the old certificates or the issuance of new certificates bearing different numbers from those sold is, we submit, of no real significance. This Court has recognized that certificates of stock are not the property itself but merely the evidence of it and that a certificate for the same number of shares represents precisely the same kind and value of property as another

certificate for a like number of shares in the same corporation; that the return by a broker of a different certificate or the substitution of one certificate for another makes no material change in the property right of the customer; that such shares are unlike distinct articles of personal property, differing in kind or value, as a horse, wagon, or harness, and that stock has no earmark which distinguishes one share from another but is like grain of a uniform quality in an elevator, one bushel being of the same kind and value as another. *Gorman* v. *Littlefield,* 229 U. S. 19, 23. See also *Duel* v. *Hollins,* 241 U. S. 523; 1 Williston on Sales (2d ed.), Sections 146–159.

In the present case, what one member of the family disposed of by sale, namely, certain shares of corporate stock, another member of the family acquired by purchase. The preconceived plan that the sale by one member should be followed by the purchase by another member of identical property indisputably establishes a connection between the sale and the purchase and between the seller and the purchaser. It is this connection that establishes the transaction as being "between" them, and to the extent that there is a formal hiatus in the execution of the plan on the Stock Exchange, that hiatus is rendered immaterial by the use of the word "indirectly" in Section 24 (b) (1).

We respectfully submit that the statute should be construed so as to give effect to the legislative purpose. See *United States* v. *Amer. Trucking Ass'ns*, 310 U. S. 534, 544. Particularly is this true where a taxpayer, as here, is claiming a deduction from gross income, for he must show that he comes squarely within the terms of the statutory provision allowing the deduction. *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440; *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49; *Deputy* v. *duPont*, 308 U. S. 488, 493; *White* v. *United States*, 305 U. S. 281, 292; *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686, 689–690; *McDonald* v. *Commissioner*, 323 U. S. 57, 60; *Equitable Society* v. *Commissioner*, 321 U. S. 560, 564; *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, 593.

The section of the Act under which the taxpayers claim the losses is Section 23 (e) of the Internal Revenue Code (26 U. S. C. 1940 ed., Sec. 23), allowing losses on transactions entered into for profit. Section 24 (b) is an express limitation upon the loss provision, and provides that no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly, between members of a family, and defines family as including one's spouse and one's ancestors. Since the court below was construing a limitation on a deduction, it would seem proper for it to have resolved any

doubt about the meaning of the word "indirectly" in favor of the Commissioner and against the taxpayer.

3. *The Tax Court's interpretation of Section 24 (b) (1) was reviewable by the court below.*— The taxpayers contend that the court below erred in reversing a factual finding of the Tax Court supported by substantial evidence, contrary to the rule first laid down by this Court in *Dobson* v. *Commissioner*, 320 U. S. 489 (Br. 4). But there is no dispute between the parties as to the facts, and the Government does not challenge a single finding of fact made by the Tax Court. The Government challenges only the rule of law announced by the Tax Court that (R. 16):

> * * * where listed securities are sold through the Stock Exchange to an unknown purchaser, and like securities are purchased through the Exchange from an unknown seller by some person having a relationship to the seller such as that described in section 24 (b) (1), Internal Revenue Code, the transaction does not constitute a sale of property upon which a loss deduction is denied under the statute.

The decision of the Tax Court did not involve the mere application of the statute to a particular set of facts. It undertook to establish a rule of general applicability; it constituted an interpretation of Section 24 (b), and particularly of the word "indirectly". The issue is therefore one of

law. *Trust of Bingham* v. *United States*, 325 U. S. 365.[9]

The Government does not argue that every application of this statute to a particular set of facts by the Tax Court is reviewable. Thus, we would agree that the *Dobson* rule applies if the Tax Court, in ruling against the Commissioner, had found, on substantial evidence, that a taxpayer had sold the same number of shares of the same stock which, by pure coincidence, had been purchased on the same day by a member of his family in another city. But where the purchase and sale are parts of a single plan, as shown by undisputed findings of the Tax Court, then the Tax Court errs as a matter of law when it holds that the statute is inapplicable by reason of the interposition of the Stock Exchange between the members of the family involved. Such a general ruling, which is not limited to the facts of the

[9] See also *Crane* v. *Commissioner*, No. 68, this Term, decided April 14, 1947; *Security Mills Co.* v. *Commissioner*, 321 U. S. 281, 286; *Douglas* v. *Commissioner*, 322 U. S. 275; *Commissioner* v. *Harmon*, 323 U. S. 44; *McDonald* v. *Commissioner*, 323 U. S. 57; *Claridge Apartments Co.* v. *Commissioner*, 323 U. S. 141, 145; *Fondren* v. *Commissioner*, 324 U. S. 18; *Choate* v. *Commissioner*, 324 U. S. 1; *Commissioner* v. *Estate of Field*, 324 U. S. 113; *Webre Steib Co.* v. *Commissioner*, 324 U. S. 164; *Commissioner* v. *Smith*, 324 U. S. 177; *Commissioner* v. *Wemyss*, 324 U. S. 303; *Commissioner* v. *Wheeler*, 324 U. S. 542; *Estate of Putnam* v. *Commissioner*, 324 U. S. 393; *Angelus Milling Co.* v. *Commissioner*, 325 U. S. 293; *Commissioner* v. *Estate of Bedford*, 325 U. S. 283; *Commissioner* v. *Disston*, 325 U. S. 442.

particular case, and which misconceives the scope of the statute, is plainly subject to appellate review.

CONCLUSION

The decision of the court below is correct and should therefore be affirmed.

Respectfully submitted.

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APRIL, 1947.

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SUPREME COURT OF THE UNITED STATES

Nos. 945, 946 AND 947.—OCTOBER TERM, 1946.

John P. McWilliams, Petitioner, 945 *v.* Commissioner of Internal Revenue. Estate of Susan P. McWilliams, Deceased, John P. McWilliams, Executor, Petitioners, 946 *v.* Commissioner of Internal Revenue. Brooks B. McWilliams, Petitioner, 947 *v.* Commissioner of Internal Revenue.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[June 16, 1947.]

MR. CHIEF JUSTICE VINSON delivered the opinion of the Court.

The facts of these cases are not in dispute. John P. McWilliams, petitioner in No. 945, had for a number of years managed the large independent estate of his wife, petitioner in No. 947, as well as his own. On several occasions in 1940 and 1941 he ordered his broker to sell certain stock for the account of one of the two, and to buy the same number of shares of the same stock for the other, at as nearly the same price as possible. He told the broker that his purpose was to establish tax losses. On each occasion the sale and purchase were promptly negotiated through the Stock Exchange, and the identity of the persons buying from the selling spouse and of the persons selling to the buying spouse was never known. Invariably, however, the buying spouse received stock certificates different from those which the other had

sold. Petitioners filed separate income tax returns for these years, and claimed the losses which he or she sustained on the sales as deductions from gross income.

The Commissioner disallowed these deductions on the authority of § 24 (b) of the Internal Revenue Code,[1] which prohibits deductions for losses from "sales or exchanges of property, directly or indirectly . . . between members of a family," and between certain other closely related individuals and corporations.

On the taxpayers' applications to the Tax Court, it held § 24 (b) inapplicable, following its own decision in *Ickelheimer* v. *Commissioner*,[2] and expunged the Commission-

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[1] The material parts of § 24 (b) are as follows:

"(b) *Losses from sales or exchanges of property.*

"(1) *Losses disallowed.* In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

"(A) Between members of a family, as defined in paragraph (2) (D);

"(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

"(C) Except in the case of distributions in liquidation, between two corporations more than 50 per centum in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

"(D) Between a grantor and a fiduciary of any trust;

"(E) Between the fiduciary of a trust and the fiduciary of another trust, if the same person is a grantor with respect to each trust; or

"(F) Between a fiduciary of a trust and a beneficiary of such trust."

Section 24 (b) (2) (D) defines the family of an individual to include "only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; . . ."

[2] 45 B. T. A. 478, affirmed, 132 F. 2d 660 (CCA 2).

er's deficiency assessments.[3] The Circuit Court of Appeals reversed the Tax Court[4] and we granted certiorari[5] because of a conflict between circuits[6] and the importance of the question involved.

Petitioners contend that Congress could not have intended to disallow losses on transactions like those described above, which, having been made through a public market, were undoubtedly bona fide sales, both in the sense that title to property was actually transferred, and also in the sense that a fair consideration was paid in exchange. They contend that the disallowance of such losses would amount, *pro tanto*, to treating husband and wife as a single individual for tax purposes.

In support of this contention, they call our attention to the pre-1934 rule, which applied to all sales regardless of the relationship of seller and buyer, and made the deductibility of the resultant loss turn on the "good faith" of the sale, *i. e.*, whether the seller actually parted with title and control.[7] They point out that in the case of the usual intra-family sale, the evidence material to this

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[3] 5 T. C. 623.

[4] 158 F. 2d 637 (CCA 6).

[5] — U. S. —. In No. 946, the petition for certiorari of the Estate of Susan P. McWilliams, the deceased mother of John P. McWilliams, was granted at the same time as the petitions in Nos. 945 and 947, and the three cases were consolidated in this Court. As all three present the same material facts and raise precisely the same issues, no further reference will be made to the several cases separately.

[6] The decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Ickelheimer*, *supra*, note 2, is in conflict on this point with the decision of the Circuit Court of Appeals for the Sixth Circuit in the present case, and also with that of the Circuit Court of Appeals for the Fourth Circuit in *Commissioner* v. *Kohn*, 158 F. 2d 32.

[7] *Commissioner* v. *Hale*, 67 F. 2d 561 (CCA 1); *Zimmerman* v. *Commissioner*, 36 B. T. A. 279, reversed on other grounds, 100 F. 2d 1023 (CCA 3); *Uihlein* v. *Commissioner*, 30 B. T. A. 399, affirmed, 82 F. 2d 944 (CCA 7).

issue was peculiarly within the knowledge and even the control of the taxpayer and those amenable to his wishes, and inaccessible to the Government.[8] They maintain that the only purpose of the provisions of the 1934 and 1937 Revenue Acts—the forerunners of § 24 (b)[9]—was to overcome these evidentiary difficulties by disallowing losses on such sales irrespective of good faith. It seems to be petitioners' belief that the evidentiary difficulties so contemplated were only those relating to proof of the parties' observance of the formalities of a sale and of the fairness of the price, and consequently that the legislative remedy applied only to sales made immediately from one member of a family to another, or mediately through a controlled intermediary.

We are not persuaded that Congress had so limited an appreciation of this type of tax avoidance problem. Even assuming that the problem was thought to arise solely out of the taxpayer's inherent advantage in a contest concerning the good or bad faith of an intra-family sale, deception could obviously be practiced by a buying spouse's agreement or tacit readiness to hold the property sold at the disposal of a selling spouse, rather more easily than by a pretense of a sale where none actually occurred, or by an unfair price. The difficulty of determining the finality of an intra-family transfer was one with which the courts wrestled under the pre-1934 law,[10] and which

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[8] See H. Rep. No. 1546, 75th Cong., 1st Sess., p. 26 (1939–1 Cum. Bull. (Part 2) 704, 722–723). See also cases cited in note 7, *supra*.

[9] The provisions of § 24 (b) (1) (A) and (B) of the Internal Revenue Code originated in § 24 (a) (6) of the Revenue Act of 1934, 48 Stat. 680, 691. These provisions were reenacted without change as § 24 (a) (6) of the Revenue Act of 1936, 49 Stat. 1648, 1662, and the provisions of § 24 (b) (1) (C), (D), (E), and (F) of the Code were added by § 301 of the 1937 Act, 50 Stat. 813, 827.

[10] Cf. *Shoenberg* v. *Commissioner*, 77 F. 2d 446 (CCA 8); *Cole* v. *Helburn*, 4 F. Supp. 230; *Zimmerman* v. *Commissioner*, *supra*, note 7.

Congress undoubtedly meant to overcome by enacting the provisions of § 24 (b).[11]

It is clear, however, that this difficulty is one which arises out of the close relationship of the parties, and would be met whenever, by prearrangement, one spouse sells and another buys the same property at a common price, regardless of the mechanics of the transaction. Indeed, if the property is fungible, the possibility that a sale and purchase may be rendered nugatory by the buying spouse's agreement to hold for the benefit of the selling spouse, and the difficulty of proving that fact against the taxpayer, are equally great when the units of the property which the one buys are not the identical units which the other sells.

Securities transactions have been the most common vehicle for the creation of intra-family losses. Even if we should accept petitioners' premise that the only purpose of § 24 (b) was to meet an evidentiary problem, we could agree that Congress did not mean to reach the transactions in this case only if we thought it completely indifferent to the effectuality of its solution.

Moreover, we think the evidentiary problem was not the only one which Congress intended to meet. Section 24 (b) states an absolute prohibition—not a presumption—against the allowance of losses on any sales between the members of certain designated groups. The one common characteristic of these groups is that their members, although distinct legal entities, generally have a near-identity of economic interests.[12] It is a fair inference that even legally genuine intra-group transfers were not thought to result, usually, in economically genuine realizations of loss, and accordingly that Congress did not deem

[11] See H. Rep. No. 1546, 75th Cong., 1st Sess., p. 24, *supra*, note 8.

[12] See the text of § 24 (b) (1), quoted in note 1.

them to be appropriate occasions for the allowance of deductions.

The pertinent legislative history lends support to this inference. The Congressional Committees, in reporting the provisions enacted in 1934, merely stated that "the practice of creating losses through transactions between members of a family and close corporations has been frequently utilized for avoiding the income tax," and that these provisions were proposed to "deny losses to be taken in the case of [such] sales" and "to close this loophole of tax avoidance." [13] Similar language was used in reporting the 1937 provisions.[14] Chairman Doughton of the Ways and Means Committee, in explaining the 1937 provisions to the House, spoke of "the artificial taking and establishment of losses where property was shuffled back and forth between various legal entities owned by the same persons or person," and stated that "these transactions seem to occur at moments remarkably opportune to the real party in interest in reducing his tax liability but, at the same time allowing him to keep substantial control of the assets being traded or exchanged." [15]

We conclude that the purpose of § 24 (b) was to put an end to the right of taxpayers to choose, by intra-family

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[13] H. Rep. No. 704, 73d Cong., 2d Sess., p. 23 (1939–1 Cum. Bull. (Part 2) 554, 571); S. Rep. No. 558, 73d Cong., 2d Sess., p. 27 (1939–1 Cum. Bull. (Part 2) 586, 607).

[14] The type of situations to which these provisions applied was described as being that "in which due to family relationships or friendly control, artificial losses might be created for tax purposes." H. Rep. No. 1546, 75th Cong., 1st Sess., p. 28 (1939–1 Cum. Bull. (Part 2) 704, 724).

[15] 81 Cong. Rec. 9019. Representative Hill, chairman of a House subcommittee on the income-tax laws, explained to the House with reference to the 1934 provisions that the Committee had "provided in this bill that transfers between members of the family for the purposes of creating a loss to be offset against ordinary income shall not be recognized for such deduction purposes." 78 Cong. Rec. 2662.

transfers and other designated devices, their own time for realizing tax losses on investments which, for most practical purposes, are continued uninterrupted.

We are clear as to this purpose, too, that its effectuation obviously had to be made independent of the manner in which an intra-group transfer was accomplished. Congress, with such purpose in mind, could not have intended to include within the scope of § 24 (b) only simple transfers made directly or through a dummy, or to exclude transfers of securities effected through the medium of the Stock Exchange, unless it wanted to leave a loop-hole almost as large as the one it had set out to close.

Petitioners suggest that Congress, if it truly intended to disallow losses on intra-family transactions through the market, would probably have done so by an amendment to the wash sales provisions,[16] making them applicable where the seller and buyer were members of the same family, as well as where they were one and the same individual. This extension of the wash sales provisions, however, would bar only one particular means of accomplishing the evil at which § 24 (b) was aimed, and the

[16] Sec. 118 of the Internal Revenue Code, which first appeared in its present form as § 118 of the Revenue Act of 1932, 47 Stat. 169, 208, provides in part as follows:

"§ 118. *Loss from wash sales of stock or securities.*

"(a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23 (e) (2); nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business."

necessity for a comprehensive remedy would have remained.

Nor can we agree that Congress' omission from § 24 (b) of any prescribed time interval, comparable in function to that in the wash sales provisions, indicates that § 24 (b) was not intended to apply to intra-family transfers through the Exchange. Petitioners' argument is predicated on the difficulty which courts may have in determining whether the elapse of certain periods of time between one spouse's sale and the other's purchase of like securities on the Exchange is of great enough importance in itself to break the continuity of the investment and make § 24 (b) inapplicable. . .

Precisely the same difficulty may arise, however, in the case of an intra-family transfer through an individual intermediary, who, by pre-arrangement, buys from one spouse at the market price and a short time later sells the identical certificates to the other at the price prevailing at the time of sale. The omission of a prescribed time interval negates the applicability of § 24 (b) to the former type of transfer no more than it does to the latter. But if we should hold that it negated both, we would have converted the section into a mere trap for the unwary.[17]

Petitioners also urge that, whatever may have been Congress' intent, its designation in § 24 (b) of sales "between" members of a family is not adequate to compre-

[17] We have noted petitioners' suggestion that a taxpayer is assured, under the wash sales provisions, of the right to deduct the loss incurred on a sale of securities, even though he himself buys similar securities thirty-one days later; and that he should certainly not be precluded by § 24 (b) from claiming a similar loss if the taxpayer's spouse, instead of the taxpayer, makes the purchase under the same circumstances. We do not feel impelled to comment on these propositions, however, in a case in which the sale and purchase were practically simultaneous and the net consideration received by one spouse and that paid by the other differed only in the amount of brokers' commissions and excise taxes.

hend the transactions in this case, which consisted only of a sale of stock by one of the petitioners to an unknown stranger, and the purchase of different certificates of stock by the other petitioner, presumably from another stranger.

We can understand how this phraseology, if construed literally and out of context, might be thought to mean only direct intra-family transfers. But petitioners concede that the express statutory reference to sales made "directly or indirectly" precludes that construction. Moreover, we can discover in this language no implication whatsoever that an indirect intra-family sale of fungibles is outside the statute unless the units sold by one spouse and those bought by the other are identical. Indeed, if we accepted petitioners' construction of the statute, we think we would be reading into it a crippling exception which is not there.

Finally, we must reject petitioners' assertion that the *Dobson* rule[18] controls this case. The Tax Court found the facts as we stated them, and then overruled the Commissioner's determination because it thought that § 24 (b) had no application to a taxpayer's sale of securities on the Exchange to an unknown purchaser, regardless of what other circumstances accompanied the sale. We have decided otherwise, and on our construction of the statute, and the conceded facts, the Tax Court could not have reached a result contrary to our own.[19]

Affirmed.

MR. JUSTICE BURTON took no part in the consideration or decision of these cases.

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[18] *Dobson v. Commissioner*, 320 U. S. 489.

[19] Cf. *Trust of Bingham v. Commissioner*, 325 U. S. 365.